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Federal Communications Commission

WASHINGTON, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)

Implementation of the Cable)
Television Consumer Protection)
and Competition Act of 1992)

Rate Regulation)

MM Docket No. 92-266

**REPLY COMMENTS OF
THE FALCON CABLE GROUP**

The Falcon Cable Group ("Falcon"), by its attorneys, hereby submits its reply comments in the above-captioned proceeding. In its initial comments, Falcon offered its views and proposals with respect to a wide range of issues regarding the implementation of the rate regulation provisions of the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act" or "Act").¹ In these brief reply comments, Falcon focuses on four of the proposals discussed in its initial comments: (1) allowing use of a "free cash flow" test as an intermediate step between a benchmark approach and a full cost-of-service approach; (2) adjusting the basic tier benchmark to account for the costs of carrying non-satellite delivered distant broadcast stations; (3) adopting a penetration adjustment in the benchmark for non-basic

¹Pub. L. 102-385, 106 Stat. 1460 (1992). No. of Copies rec'd
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tiers; and (4) granting "small system relief" to individual franchises or groups of jointly regulated franchises.

**I. THE COMMISSION SHOULD ADOPT A "FREE CASH FLOW"
TEST AS AN INTERMEDIATE RATE REGULATION STANDARD**

In its initial comments in this proceeding, Falcon expressed its clear preference for the adoption of a "benchmark" approach rather than a "cost-of-service approach" as the principal method of establishing a "reasonable" rate for the basic service tier and for measuring whether rates for non-basic tiers are "unreasonable."² Moreover, while we acknowledged that a cost-of-service approach should be available as a "safety net" where the benchmark rate does not account for certain atypical costs incurred by an operator, we suggested that the Commission consider adopting an intermediate test based on a system's "free cash flow."

To reiterate briefly, free cash flow is cash flow from operations after deductions for debt service and capital expenditures.³ Under Falcon's proposal, free cash flow would be utilized in determining whether a system's basic rate is reasonable or whether a non-basic rate is unreasonable in situations where the rate in question is higher than the

²See Comments of Falcon Cable Group, MM Docket No. 92-266 at 24-25 (filed Jan. 27, 1993) ("Falcon Comments"). Falcon notes that the consensus view among other parties filing comments supports the benchmark approach. See, e.g., NCTA Comments at 2; City of Thousand Oaks, CA Comments at 6; NATOA Comments at 40-41.

³For a more complete description of the "free cash flow" methodology, see Falcon Comments at 32-35.

benchmark and the system is generating a profit.⁴ More specifically, as long as the system's free cash flow is not exceeding the system's projected debt service and capital expenditures by a specified margin, the rate would not be deemed unreasonable.

As an intermediate test, free cash flow has significant advantages over a cost-of-service approach. Most significantly, it is far more easily applied and does not require a uniform system of accounts. The importance of a readily calculable test cannot be overstated, given the limited resources and expertise of many local regulatory bodies.⁵ Moreover, because most loan agreements require cable operators to maintain a sufficient free

⁴If the system was not making a profit, the rate would be deemed reasonable without having to go further. (Profit means net income after depreciation and interest, a calculation made using generally accepted accounting principles.) As Falcon stated in its comments, the propriety and accuracy of all figures used could be attested to by the cable operator's outside auditors.

⁵Falcon's concerns about the ability of regulators to apply more complex rate calculations are unwittingly illustrated by NAB which proposes a rate methodology based on a combination of capital and non-capital costs. In its description of that methodology, NAB suggests that its formula is easy to apply and, thus, can be left for franchising authority determination. Yet, NAB's own demonstration of how easy it is to apply this test, attached as Appendix A to its comments, reveals that even NAB is unable to calculate costs accurately. NAB has made a number of basic errors in both capital and non-capital cost derivations. As just one example, Appendix A derives a figure for Falcon's "monthly per-sub expense" by dividing Falcon's "annual operating expense" (\$38.58M) by Falcon's "basic subs" (892,000). However, the figure used by NAB for Falcon's "annual operating expense" only reflects the expenses of Falcon Cable Systems, Inc., a publicly traded portion of the Falcon Cable Group that serves only 130,000 subscribers. If NAB itself can make such a fundamental error in applying its own approach, one can only imagine the problems that will be encountered at the local regulatory level.

cash flow, the proposed test will ensure that the strict application of benchmarking will not force systems to maintain rates at a level that will cause loan defaults and the disruption to service that would invariably follow.

The 1992 Cable Act states that a cable operator is to be permitted a "reasonable profit." Quite obviously, if a cable system has little or no free cash flow, although it may be profitable, there are no monopoly profits to be concerned about. Thus, a free cash flow test for a profitable system whose rate exceeds the applicable benchmark would help demonstrate whether the profit is reasonable.

**II. THE BASIC TIER BENCHMARK SHOULD BE ADJUSTED
TO ACCOUNT FOR THE CARRIAGE OF NON-SATELLITE
DELIVERED DISTANT BROADCAST SIGNALS**

As Falcon pointed out in its initial comments, the Commission should allow certain objective cost elements to be added to the per-channel basic tier benchmark rate.⁶ In particular, Falcon is concerned about the situation presented by "classic" cable systems operating in areas with few available "local" broadcast signals that have historically imported a number of non-satellite distant broadcast signals from other markets. For example, since 1971 Falcon's San Luis Obispo system has carried four distant stations via terrestrial microwave from Los Angeles, over 200 miles away. Falcon's 32 percent share of the capital costs for the consortium-owned microwave link was

⁶Falcon Comments at 25.

\$181,000 and its share of the recurring costs is \$32,000 per year.

While these stations do not have to be carried at all, they are an extremely valued element of Falcon's service and their deletion would disserve the public interest. Their carriage is in furtherance of the Commission's policies implementing the goal of Section 307(b) of the Communications Act ". . . to provide a fair, efficient, equitable distribution of radio service to [all communities]." Rural communities, distant from large markets, cannot presently obtain the same "radio service" as communities in or near larger markets without the intervention of cable systems. There are no full-power independent or educational television stations receivable off-the-air in the San Luis Obispo area and, indeed, approximately 70 percent of the homes cannot receive all three major networks. Falcon's cable system is the agent for equalizing television service for these people. The Commission therefore should allow an adjustment to its per-channel basic tier benchmark to allow the recovery of the costs of obtaining and retransmitting distant signals in such circumstances plus a reasonable profit as a means of providing an incentive for their continued carriage.

**III. THE COMMISSION SHOULD ADJUST THE NON-BASIC TIER
BENCHMARK TO REFLECT VARIATIONS IN PENETRATION**

As Falcon noted in its initial comments, it is impossible to account for all the variations in non-basic service tiers with a

single, per-channel benchmark.⁷ On the other hand, it is equally impossible to formulate separate benchmarks to reflect every possible combination of non-basic services and equipment. Falcon thus urged the Commission to build the maximum possible flexibility into the non-basic benchmarks. One aspect of this approach is an adjustment based on the non-basic tier's penetration.

Tiers that are aimed at narrow audience groups or that have fewer channels typically have lower penetration than a single tier which includes a large number of popular programming services. As penetration drops, so do the advertising revenues available to support the tier, resulting in higher fees charged to the cable operator for the service. Adjusting the non-basic benchmark upward where penetration is low will allow operators to recover these higher fees and, thus, continue to offer a greater degree of choice to their subscribers.⁸ Congress expressed a desire to give subscribers more choices, not only of services, but also how those services are packaged. An adjustment like that suggested by Falcon promotes movement toward an a la carte menu of services. This is consistent with the regulatory continuum designed by Congress whereby a basic tier of services

⁷Falcon Comments at 58-64.

⁸While the relationship between tier size and penetration is not a perfect one, the fact that smaller tiers typically have fewer subscribers is relevant. Under the Act, per channel services are completely deregulated. It is consistent with this policy to reduce regulatory oversight, and permit more flexible pricing, as tiers diminish in size (with the exception of the basic tier, which, of course, has 100% penetration).

is fully rate regulated and single-channel premium services are not rate regulated at all. Low penetration tiers more closely resemble premium services than universal service tiers, thus their regulation should be far more flexible.

**IV. THE AVAILABILITY OF SMALL SYSTEM RELIEF SHOULD
BE DETERMINED ON A FRANCHISE-BY-FRANCHISE BASIS**

Finally, as Falcon indicated in its initial comments, the Commission should apply provisions adopted to reduce the burden of complying with the Act's rate regulation requirements on a franchise-by-franchise basis.⁹ The essential unit of rate regulation under the Act is the franchise area. Effective competition is determined on a franchise-by-franchise basis and, in most instances, regulation of basic rates will be implemented on a franchise-by-franchise basis. One exception may be where a group of franchising authorities obtains certification jointly to regulate the basic rates of a multi-community, integrated system. In such cases, the subscriber totals for the communities covered by the joint certification may be aggregated to determine whether small system relief is available.

Some commenters have argued not only that small system relief should be applied on a system-wide rather than franchise-wide basis, but also that relief should not be available where the systems are part of an MSO.¹⁰ This interpretation of the small system relief provision is directly at odds with the plain

⁹Falcon Comments at 85-87.

¹⁰See, e.g., NATOA Comments at 88.

language of the statute (which draws no such distinction) and with the legislative history (which supports the conclusion that no such distinction was intended).¹¹ Furthermore, distinguishing between MSOs and independent systems makes no sense. Indeed, if an MSO is not entitled to administrative relief for its smaller operating units, those units will end up bearing some of the higher administrative costs incurred by the MSO's larger systems. Moreover, some MSOs, like Falcon, are predominantly made up of small systems.

CONCLUSION

Falcon commends these points, as well as those made in its initial comments, to the Commission's attention as it deliberates the issues in this crucial proceeding.

Respectfully submitted,

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¹¹See 138 Cong. Rec. H6525-26 (July 23, 1992) (statements by Rep. Cooper opposing the small system relief provision because, "[t]he way the amendment is drafted," it would exempt MSO systems as well as independent systems).